

Testimony of Todd McCracken

President

**On Behalf of
The National Small Business Association**



House Small Business Committee

Hearing:

**“Electronic Payments Tax Reporting: Another Tax Burden for
Small Businesses”**

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Chairwoman Velazquez, Ranking Member Chabot and Members of the Committee, on behalf of the 150,000 small-business owners represented by the National Small Business Association, I would like to thank you for the opportunity to appear today to discuss the administration's budget proposal to require information tax reporting on all credit card receipts of small businesses.

As the nation's oldest nonpartisan small business group, our top priority for the 110th Congress is working to find a solution to the tax gap—the difference between taxes owed and taxes actually paid—without placing excessive and intrusive burdens on honest small business owners.

Small business tends to be an easy target since many small-business owners cannot afford to employ teams of accountants and lawyers to fight their cases—a luxury enjoyed by big business. Approximately 36 percent of NSBA members have less than 5 employees—few, in any, of whom is a tax attorney—leaving business owners with no other choice but to hire outside help to keep track of all their paperwork.

Not only is the burden a heavy one, but it is disproportionate as well. According to the U.S. Small Business Administration (SBA) Office of Advocacy, the cost of tax compliance for small firms is 67 percent higher than for their larger counterparts. For firms with less than twenty employees, the per-employee cost of complying with the tax code is \$1,304. Now the administration is trying to further complicate and scrutinize our tax system by considering expanding information reporting requirements on business owner's annual electronic payment transactions.

Information Reporting Requirements on Merchant Payment Card Transactions

The basic premise of the proposal is that a "payment facilitator" would provide the Internal Revenue Service (IRS) and the merchant with an annual, aggregate total of the gross receipts an individual merchant processed with that payment facilitator. After thorough review, NSBA has found that this recommendation would not effectively

increase compliance and minimize the tax gap. Instead, it will add additional and unnecessary regulatory, reporting and withholding burdens on already over-burdened small-business owners—all in an effort to try to catch other businesses that might not be reporting all of their income.

It must be said—NSBA does not condone the non-payment of tax obligations. The overwhelming majority of small businesses are honest, hard-working organizations that are critical to the economic success of the American economy. Given the extraordinary burden that compliance with the unbelievably complex tax code already imposes on small businesses, it is unfair to ask truthful small businesses to do even more in order to catch a few potential cheats.

Currently, taxpayers are subject to some level of information reporting and withholding requirements. Employers must report wages and withhold applicable payroll taxes and federal income taxes for their employees. Businesses are required to report payments made for services in connection with their trade and business of more than \$600 per year. However, the administration's proposal on increasing information reporting by requiring credit and debit card issuers to report to the IRS annually on aggregate reimbursement payments made to businesses, would be extremely burdensome and raises questions of intrusiveness on the business owner.

Use of Data

NSBA has significant concerns about the use of the data collected by the IRS. In theory, the IRS can conduct some sort of matching exercise with a merchant's reported gross receipts on tax returns. Additionally, the data could be used by the IRS for the purpose of developing trends and reporting profiles, by taking the total credit card receipts reported for a particular business and then extrapolating total income based on industry averages. According to a recent NSBA survey, 93 percent of our members do not support the IRS using the collected information for determining whether businesses are accurately reporting their gross receipts.

Not only would it be difficult to determine an applicable average for a particular small business, creating a huge new audit burden on companies that may legitimately fall outside their industries' "averages" but it also raises privacy concerns. The new industry profiles would then be used by the IRS to judge other items on a tax return.

For example, the IRS might see that dry cleaners make an average of 60 percent of their transactions through credit cards, so if the agency reviewed the tax return of a dry cleaner that significantly deviated from that average, it may question that return. In turn, that business may be more likely to be audited, especially since the IRS has, in the last two years alone, increased audits of small corporations by 150 percent and there is every reason to believe that number will continue to increase.

The sheer volume of the information returns generated by this proposal will ensure most of it will never be evaluated or used by the IRS. NSBA questions how the IRS will be able to match and use the information reported by the processor to identify merchants that are truly underreporting electronic payments, or that reliable composites of gross receipts reporting including projected cash transactions can be developed. The diversity of merchant activity based on industry, geographic location and even an owner's efforts to manage cash flow or acceptance of only certain credit cards are all factors that make the latter objective more difficult.

Backup Withholding

Additionally, the proposal requires that the credit and debit card processors verify the business's Taxpayer Identification Number (TIN). If the merchant fails to verify the TIN or the information is inaccurate, the processors must backup withhold 28 percent of businesses transactions. Eighty percent of those surveyed by the NSBA do not believe it is fair or reasonable for credit and debit card companies to withhold 28 percent of their gross receipts.

Meanwhile no specifics have been outlined on how the IRS plans to work with these credit and debit card companies to implement this proposal. Although the burden is intended to be placed on the processor to verify the TIN, it is likely if there are any mistakes the burden will fall back on the business, requiring them to deal with the IRS and certify that their TIN is correct.

Small business owners should be given a reasonable amount of time to correct any errors with their TINs before processors backup withholding begins. NSBA supports an accurate and real-time verification system that is easily accessible via online or phone to businesses so they can properly verify these TINs. Otherwise, there will be significant reporting errors and delays in services while trying to verify TINs. A system with substantial requests for paperwork and long wait times to receive needed approvals would harm daily operations of the business and disrupt the companies' cash flow.

Cost Concerns

It is not clear whether merchant processors have a system in place that could accurately and efficiently report the merchant's payment card receipts to the IRS. If such a system is required and it imposes an additional cost to the merchant processor, that cost could be passed on to the small business. A disparity will exist when the merchant processor is reporting payment card transactions and small businesses are reporting both payment card transactions and cash transactions without distinguishing between the two. Further, there is no data available to differentiate between payment card transactions and cash transactions as a contributor of the tax gap.

NSBA understands the recommendation is appealing because the direct impact on a merchant is perceived to be limited. Nevertheless, this new level of regulatory burden on credit card issuers likely will lead to increased fees being passed on to businesses which conduct credit card transactions. These increased fees will have a negative impact on business revenue and sales, and in turn tax revenue.

Some members of the small business community have expressed concern that if the proposal becomes law, some small firms may stop taking credit cards or will have to charge higher prices because of the cost to comply. According to the NSBA member survey, if this regulation became law 60 percent of the respondents would change the way they conduct business accounting which would ultimately have a negative financial impact on consumers and severe consequences on our already weak economy.

Administration Recommendation Conclusions

This proposal, which calls for increased reporting requirements, will add to the existing regulatory burdens small businesses face in complying with IRS regulations. Eighty-five percent of those surveyed by NSBA do not believe that this proposal would increase tax compliance if it became law. Instead of using resources to invest and grow their businesses, owners will now be forced to spend valuable time and financial resources on record-keeping and outside help to ensure their compliance.

The overall goal of the administration and Congress is to increase tax compliance and minimize the tax gap. However, it is not possible to completely close the tax gap. There will always be those who employ tax shelters, willfully non-comply, or inaccurately report their income. There will even be those circumstances where it is the unqualified tax preparers who are making the mistakes and should be held responsible for the filer's errors.

Beyond the invasiveness and red tape, NSBA is concerned about whether the current infrastructure and staffing levels of the IRS is adequate to handle the surge of paperwork that this proposal will create. While the concept of significantly increasing taxpayer compliance may appear justifiable, the practical impact of implementing it could be devastating to the individual taxpayer.

NSBA Position

NSBA believe efforts to close the tax gap must focus on overall simplification, eliminating inequities within the tax code, and enhancing taxpayer education and outreach. Addressing the tax gap must entail balancing the desire to collect taxes that are duly owed with the importance of minimizing intrusive and complicated reporting requirements and additional audits of small businesses. Accurate tax reporting and compliance is extremely important to small business. Those who make a good faith effort, yet are inaccurately complying should be assisted through education and tax simplification efforts. Those willfully disregarding their tax liability should be held accountable. The more assistance offered to taxpayers and the simpler it is to understand and comply with tax laws, the more taxpayers will accurately meet their tax obligations. However, increased enforcement at the expense of taxpayer education will not in the long term accomplish sustained, improved compliance.

The complexity of the IRS tax code is particularly troublesome for small-business owners and is a snare for unintentional noncompliance. Vague rules and poorly defined regulations understandably result in mistakes. In order for taxpayers to comply more easily with the tax laws, taxpayer services should include providing timely guidance on issues, promoting electronic filing of tax returns, explaining IRS notices and correspondence, and helping taxpayers with problems. With the complexity facing many taxpayers, NSBA believes a key priority should be the development and implementation of initiatives to improve IRS guidance.

NSBA concludes that the Committee should work with the IRS to conduct more research to better identify noncompliant taxpayers, enhance taxpayer services to inform taxpayers of correct tax obligations and adjust its enforcement tools to target those who intentionally evade paying taxes.

As you move forward in your efforts to close the tax gap, NSBA is hopeful that you will take our recommendations into consideration. Now is the time for Congress to support

proposals that are fair and reasonable, and that do not hinder the survival, growth and innovation of our nation's entrepreneurs.

I would like to thank Chairwoman Velazquez for holding this hearing, bringing this proposal to the forefront and for the opportunity to testify.